SUMMARY DESCRIPTION OF
REVENUE RECONCILIATION PROVISIONS
TO BE CONSIDERED BY THE WAYS AND MEANS COMMITTEE

Prepared for the

HOUSE COMMITTEE ON WAYS AND MEANS

By the Staff

of the

JOINT COMMITTEE ON TAXATION

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CONTENTS

	Page
INTRODUCTION	1
PART ONE: REVENUE RECONCILIATION PROVISIONS	1
I. PROVISIONS AFFECTING HIGHER-INCOME TAXPAYERS	
A. Income Tax Provisions	1
1. Individual income tax provisions	1
a. Child and dependent care credit: Deny credit for overnight camp expenses	1
b. Limit interest deduction: Home equity debt in excess of acquisition debt capped at $100,000; total for qualified residence debt capped at $1 million; boats and mobile homes ineligible as second homes	2
2. Employee benefits; Pensions	
a. Cap cash option under a cafeteria plan: $500 per year	3
b. Modify definition of active participant for IRA rules	3
3. Limit deferral for like-kind exchange for real estate gain to $100,000 per year	5
B. Estate and Gift Taxes	
1. Rates (incl. rate freeze) and unified credit	6
2. Valuation of property (estate tax freezes and minority discount)	7
3. Change State death tax credit to deduction	8
4. ESOP estate tax deduction	9
II. BUSINESS REFORM PROVISIONS	

A. Accounting Provisions.....

1. Repeal completed contract method..... 10

2. Apply Section 265 to holders of installment sale obligations of State and local governments..... 11

3. Below-market loans to certain continuing-care facilities..... 12

4. Repeal cash method of accounting for farms with receipts over $5 million.. 13

5. Require current accrual of market discount on bonds..... 14

6. Amortization of customer base intangibles..... 15

7. Repeal vacation pay reserve..... 16

B. Partnership Provisions.....

1. Treatment of certain limited partners..... 17

2. Treatment of tax-exempt partners..... 20

C. Mergers, Acquisitions, and Corporate Transactions.....

1. Reduction of tax avoidance in certain corporate dispositions..... 21

2. Debt financing and corporate acquisitions..... 22

3. Corporate Raider Tax Act..... 23

4. Modify computation of earnings and profits for intercorporate dividends and basis adjustments (overrule Woods Investment Company case)..... 24

5. Limit consolidated return pass-through. 25

6. Tax loss mergers and benefit acquisitions..... 26

7. Tax benefitted transfers through intercorporate dividends received deduction (including preferred stock loss transfers): 80% DRD denied for

certain non-stock characteristics..... 27

8. Limitations on net operating loss carryforwards of corporations..... 28

9. Denial of graduated sales for personal service corporations..... 29

10. LIFO recapture on conversion from C corporation to S corporation..... 30

D. Minimum Tax Provisions: Increase book and adjusted current earnings preference to 100%..... 31

E. Foreign Tax Provisions.....

1. Income from runaway plants..... 32

2. Treatment of South African income..... 33

F. Insurance Provisions.....

1. Minimum tax treatment of mutual life insurance companies..... 34

2. Treatment of investment income of foreign insurance companies..... 35

3. Treatment of certain insurance syndicates..... 36

4. Interest Rate Used in Computing Reserves for Life Insurance and Annuity Contracts..... 37

G. Unrelated Business Income Tax (UBIT) on Net Investment Income of Trade Associations.... 38

H. Pensions: Modify full-funding limitation..... 39

III. EMPLOYMENT AND EXCISE TAXES; USER FEES.....

A. Employment Taxes.....

1. Expand employer share of FICA tax to include all cash tips..... 40

2. Extend FUTA repayment tax..... 41

B. Excise Taxes.....

1. Telephone excise tax: 3-year extension.. 42

2. Repeal highway excise tax exemption for buses 43

3. Collect diesel fuel and special motor fuels taxes on sales to retailer..... 44

C. Certain New User Fees.....

1. Internal Revenue Service..... 45

2. Bureau of Alcohol, Tobacco, and Firearms..... 46

3. Customs Service..... 47

IV. OTHER REVENUE-INCREASE PROVISIONS.....

A. Targeted Jobs Tax Credit..... 49

B. Compliance Provisions.....

1. IRS funding..... 50

2. Escheat of refunds..... 51

C. Debt Collection: 3-Year Extension..... 52

D. Estimated Taxes.....

1. Estimated tax penalty relief for 1987... 53

2. Corporate estimated tax..... 54

E. Tax-Exempt Bond Provisions .....

1. Limitation on issuance of tax-exempt bonds by Indian tribes 56

2. Limitation on issuance of tax-exempt bonds to acquire existing output facilities 57

F. Farm Water Subsidies as Gross Income..... 58

PART TWO: TECHNICAL CORRECTIONS 59

PART THREE: MISCELLENEOUS TAX PROVISIONS 60

PART FOUR: FAMILY WELFARE REFORM ACT..... 74

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a brief description of revenue reconciliation provisions to be considered by the Committee on Ways and Means. These provisions are scheduled for committee markup on October 15, 1987.

The first part describes revenue reconciliation provisions, which includes provisions affecting higher-income taxpayers, business reform provisions, employment and excise tax provisions and user fees, and other revenue-increase provisions. Part two makes reference to (but does not describe) the technical corrections provisions (H.R. 2636 and the Chairman's proposed amendments). Part three describes miscellaneous tax provisions. Part four makes reference to (but does not describe) the provisions of the Family Welfare Reform Act (H.R. 1720), as reported by the Committee.

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[1] This document may be cited as follows: Joint Committee on Taxation, Summary Description of Revenue Reconciliation Provisions to be Considered by the Ways and Means Committee (JCX-15-87), October 15, 1987.

I. PROVISIONS AFFECTING HIGHER-INCOME TAXPAYERS

A. Income Tax Provisions

1. Individual Income Tax Provisions

a. Deny eligibility of overnight camp expenses for child care credit

Present Law

An income tax credit is provided that is equal to up to 30 percent of certain employment-related child and dependent care expenses. For example, costs incurred by the taxpayer for a day care center or nursery school, a housekeeper or other home care, and summer camps (including overnight camps) are eligible for the credit if incurred to enable the taxpayer to work.

The amount of qualified expenses eligible for the credit is limited to $2,400 ($4,800 for the care of two or more individuals).

The 30-percent credit rate is reduced by one percentage point for each $2,000 (or portion thereof) of adjusted gross income (AGI) between $10,000 and $28,000. The credit rate is 20 percent for taxpayers with AGI exceeding $28,000.

Explanation of Provision

Costs incurred by taxpayers to send their child to an overnight camp would be ineligible for the child care credit.

Effective Date

The provision would be effective for taxable years beginning on or after January 1, 1988.

b. Limit interest deduction: Home equity debt in excess of acquisition debt capped at $100,000; total for qualified residence debt capped at $1 million; boats and mobile homes ineligible as second homes

Present Law

Under present law, personal interest (other than qualified residence interest) is not deductible, subject to a phase-in over the period 1987-1991. Under present law, a taxpayer may deduct interest on a loan secured by a lien on his or her residence, up to the amount of the original cost of the residence (plus improvements), and may also deduct the interest on certain loans secured by the residence incurred for educational or medical expenses up to the fair market value of the residence. The interest on such loans secured by the residence is deductible even though the loan proceeds are used for personal purposes. These loans are being advertised by lending institutions as "home equity loans".

Explanation of Provisions

Provision 1--The debt eligible for the qualified residence exception would be limited to debt to acquire or substantially improve the taxpayer's principal or second residence. An additional amount of interest on debt (not in excess of the fair market value of the residence) secured by the taxpayer's principal or second residence equal to $100,000 of principal ($60,000 for unmarried individuals) would be allowed.

Provision 2--The total amount of debt eligible for the qualified residence exception (notwithstanding Provision 1) would be limited to $1 million.

Provision 3--It would be expressly provided that mobile homes used on a transient basis and boats would be ineligible to qualify as second residences for purposes of the interest expense deduction.

Effective Date

The provisions would be effective for taxable years beginning after December 31, 1987. Indebtedness incurred before October 13, 1987 would be grandfathered. Refinancing of debt would be permitted to the extent that the principal amount of the refinancing does not exceed the principal amount of the old debt immediately before the refinancing, and the term of the new debt does not exceed the term of the prior debt.

2. Employee Benefits; Pensions

a. Cap cash option under a cafeteria plan: $500 per year

Present Law

Under present law, compensation generally is includible when actually or constructively received. An amount is constructively received by a taxpayer if it is made available to the taxpayer.

Under an exception to the principle of constructive receipt, no amount is included in the income (or wages for FICA and FUTA purposes) of a participant in a cafeteria plan meeting certain requirements solely because, under the plan, a taxable benefit is available to the participant. Nontaxable benefits that may be available under a cafeteria plan include, for example, health coverage, group-term life insurance, and dependent care assistance.

Explanation of Provisions

The cafeteria plan exception to the constructive receipt principle would be limited to $500 per year for purposes of the income, FICA, and FUTA taxes. Thus, the amount of cash an employee can elect to receive without triggering income inclusion would be limited to $500. For example, if an employee has a choice between contributing $750 of salary toward the purchase of health insurance and receiving that $750 in cash, and if the employee elects to buy health insurance with the $750 of salary, $250 will be taxable to the employee. On the other hand, if the employee has the option of receiving $500 in cash or $500 in benefits and also may allocate an additional $250 among various benefits, but may not take the additional $250 in cash, then none of the benefits elected would be taxable.

A plan offering an employee a choice only among nontaxable benefits (other than cash equivalents) would not be affected by this cap.

Effective Date

This provision would be effective for years beginning after December 31, 1987.

b. Modify definition of active participant for IRA rules

Present Law

Under present law, a taxpayer generally is permitted to make the maximum permissible deductible IRA contribution if

the taxpayer (1) has adjusted gross income that does not exceed an applicable dollar amount or (2) is not an active participant. The term "active participant" generally means an individual who is an active participant in (1) a qualified plan, (2) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of the United States or a State or political subdivision, or (3) a tax-sheltered annuity (sec. 403(b)), simplified employee pension, or section 501(c)(18) plan.

In a recent Tax Court decision (Porter v. Commissioner, 88 T.C. No. 28 (March 5, 1987)), it was held that Article III judges are not employees of the United States and, therefore, are not active participants in a plan established for its employees by the United States. Whether or not an individual is an employee is also relevant for other purposes under the Code, such as for the exclusion of certain benefits from income and the eligibility for certain deductions.

Explanation of Provision

The decision in Porter v. Commissioner would be overturned and judges would be treated as employees for purposes of the Code and as active participants for purposes of the IRA deduction limit.

Effective Date

This provision would be effective for years beginning after December 31, 1987.

3. Limit Deferral for Like-Kind Exchange for Real Estate Gain to $100,000 Per Year

Present Law

An exchange of property, like a sale, generally is a taxable transaction. However, no gain or loss is recognized if property held for productive use in the taxpayer's trade or business, or property held for investment purposes, is exchanged solely for property of a like-kind that also is to be held for productive use in a trade or business or for investment.

In general, any kind of real estate is treated as of like kind with all other real estate. By contrast, different types of personal property (e.g., equipment or vehicles) are not treated as of like kind. Certain types of property, such as inventory, stocks and bonds, and partnership interests, cannot be used as like-kind property.

Explanation of Provision

The amount of gain that a person could defer from the exchange of real estate would be limited to $100,000 per year.

Effective Date

The provision would be effective for exchanges on or after October 13, 1987, with an exception for exchanges pursuant to binding contracts in effect on the day before that date.

B. Estate and Gift Taxes

1. Rates and United Credit

Present Law

The gift and estate taxes are unified, so that a single progressive rate schedule is applied to an individual's cumulative gifts and bequests. A unified credit of $192,800 is deducted from the gross gift or estate tax in arriving at the net tax payable. In effect, the credit exempts the first $600,000 of aggregate transfers from estate and gift taxes.

For 1987, the gift and estate tax rates begin at 18 percent on the first $10,000 of taxable transfers and reach 55 percent on taxable transfers over $3 million. For transfers occurring after 1987, the maximum gift and estate tax rate is scheduled to decline to 50 percent for taxable transfers over $2.5 million.

Explanation of Provisions

The estate and gift tax rates applicable in 1987 would be made permanent.

The benefit of the unified credit and of the tax brackets below 55 percent would be phased out for transfers exceeding $5 million. The gift and estate tax liability for transfers in excess of $5 million would be increased by five percent of such excess until the benefit of the unified credit and lower brackets is recaptured.

Effective Date

The provisions would be effective for transfers occurring after December 31, 1987.

2. Valuation of Property (Estate Tax Freezes and Minority Discount)

Present Law

Where an individual retains enjoyment of, or the right to income from, transferred property, his gross estate includes the full value of such property. Nonetheless, a decedent's gross estate does not include the full value of a corporation where the decedent gives his children common stock in the corporation and the decedent retains control over, and the income from, the corporation through his retention of preferred stock in that corporation. Thus, by giving his children common stock in his corporation, a taxpayer may transfer appreciation in corporate assets from his estate to his children without that appreciation being subject to Federal estate or gift tax. Removing future appreciation from estate taxation is known as an estate "freeze."

In valuing the estate, courts have found that partial interests in property are worth less than a proportionate amount of the whole and that blocks of corporate stock are worth less than a pro rata share of the corporate assets. They have allowed minority discounts even where related persons together own most or all of the underlying property.

Explanation of Provisions

If an owner of a substantial interest in an enterprise transfers a disproportionate share of the appreciation in the enterprise while retaining disproportionate control or income of that enterprise, the transferred interest would be included in his gross estate.

For purposes of estate and gift tax valuation, property held, directly or indirectly, by an individual or by members of such individual's family would be treated as held by one person.

Effective Date

The estate freeze provision would be effective for decedents dying after December 31, 1987. Estate tax freezes in effect on October 13, 1987 would not be affected. The minority discount provision would be effective for transfers occurring and decedents dying after December 31, 1987.

3. Change State Death Tax Credit to Deduction

Present Law

A dollar-for-dollar credit is allowed against the Federal estate tax for any estate, inheritance, legacy, or succession taxes paid to a State in respect of any property included in the gross estate for Federal estate tax purposes. Varying with the size of the adjusted taxable estate, the maximum credit begins at .8 of 1 percent for the portion of an estate less than $90,000 and increases to 16 percent for the portion of an estate exceeding $10,040,000.

Explanation of Provision

The credit for State death taxes would be converted into a deduction.

Effective Date

The provision would be effective for decedents dying after December 31, 1987.

4. ESOP Estate Tax Deduction

These provisions are contained in H.R. 1311 introduced on February 26, 1987, by Mr. Rostenkowski and Mr. Duncan and in S. 591 introduced on the same date by Senator Bentsen.

Present Law

The 1986 Act provided generally that the taxable estate of a decedent is determined by deducting from the gross estate 50 percent of the proceeds of a sale of employer securities by an executor to an ESOP or an eligible worker-owned cooperative. The deduction is not available for sales after December 31, 1991.

Under IRS Notice 87-13, the deduction is not available unless (1) the decedent directly owned the securities immediately before death, and (2) the securities are allocable to participants.

Explanation of Provision

H.R. 1311 and S. 591 would be adopted. The bills confirm the positions taken in IRS Notice 87-13. The bills also limit the maximum allowable deduction to 50 percent of the taxable estate (without this deduction) and limit the maximum reduction in tax liability to $750,000. The deduction would be further limited to proceeds of sales of employer securities that are issued by a domestic corporation that has no publicly traded stock outstanding. Sales proceeds attributable to assets transferred from qualified plans other than ESOPs would not be eligible for the deduction. Certain holding period and allocation requirements would apply to the employer securities acquired.

Effective Date

The effective dates in the bills would apply. Thus, generally, the confirmation of IRS Notice 87-13 applies to sales of employer securities after October 22, 1986. The other provisions generally apply to sales (or, in certain cases, taxable events) after February 26, 1987.

B. Accounting Provisions

1. Repeal Completed Contract Method

Present Law

Taxpayers engaged in the production of property under a long-term contract must compute income from the contract under either the percentage of completion method or the percentage of completion-capitalized cost method. Under the percentage of completion method, income is reported based on the percentage of a contract completed during the year. Under the percentage of completion-capitalized cost method, 40 percent of a contract is reported according to the percentage of completion method, and 60 percent according to the completed contract method, under which income is reported in the year the contract is completed.

Certain small businesses may use the completed contract method fully with respect to contracts to be completed within two years.

Explanation of Provision

The percentage of completion-capitalized cost method of accounting for long-term contracts would be repealed. Thus, the full amount of all long-term contracts (other than contracts of small businesses exempted under present law) would be reported on the (100 percent) percentage of completion method.

The percentage of completion-capitalized cost method of accounting for long-term contracts would be continued as under present law in the case of contracts for the construction of not more than 5 ships, providing the ships are not constructed directly or indirectly for the Federal government and the taxpayer reasonably expects to complete the contract within 5 years.

Effective Date

The provision would be effective for contracts entered into after October 13, 1987.

2. Apply Section 265 to Holders of Installment Sales Obligations of State or Local Governments

Present Law

Under present law, if a taxpayer sells property to a State or local government in exchange for an installment obligation, interest on the obligation may be exempt from tax.

Present law generally provides that no deduction is allowed for interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is exempt from tax. However, the Internal Revenue Service has ruled (Revenue Procedure 72-18) that interest on a corporation's indebtedness is not disallowed where the corporation acquires nonnegotiable tax-exempt obligations in the ordinary course of business for services performed for, or goods supplied to, State or local governments. In addition, disallowance is not required for non-financial institutions where tax-exempt obligations do not exceed 2 percent of average assets.

Explanation of Provision

Where a taxpayer sells property and receives in exchange a tax-exempt obligation, a portion of the taxpayer's interest deductions would be disallowed. The portion disallowed would be based on the ratio of the taxpayer's average tax-exempt debt to its average assets. The de minimus rule would be set at the lesser of $1 million or 2 percent of assets.

Effective Date

The provision would apply with respect to tax-exempt installment obligations acquired after December 31, 1987.

3. Below-Market Loans to Certain Continuing Care Facilities

Present Law

Under present law, certain loans that bear interest at below-market rates are treated as loans that bear interest at a market rate accompanied by a payment from the lender to the borrower that is characterized in accordance with the substance of the particular transaction (e.g., gift, compensation, dividend, etc.).

An exception from the below-market loan rules is provided for certain loans to certain "continuing care facilities." In exchange for the making of such below-market loans, individual lenders may receive housing, meals and other personal consumption items in addition to a promise of long-term nursing care if necessary.

Explanation of Provision

The below-market loan rules would apply to below-market loans made to continuing care facilities and other similar facilities that provide consumption items in connection with the making of the loan.

Effective Date

The provision would apply to below-market loans made after October 13, 1987.

4. Repeal Cash Method of Accounting for Farms With Gross Receipts Over A Certain Amount

Present Law

Entities engaged in the trade or business of farming may generally use the cash method of accounting for such trade or business. However, if the entity is a corporation (other than an S corporation or a family-owned corporation) or is a partnership with a C corporation as a partner and has gross receipts in excess of $1 million for any taxable year beginning after 1975, an accrual method of accounting must be used. In general, a family-owned corporation is one 50 percent or more of whose stock is owned by members of the same family. Certain closely held corporations substantially owned by two or three families on October 4, 1976, and at all times thereafter also qualify as family-owned for the purposes of this exception.

If the entity engaged in the trade or business of farming is a tax shelter, it may not use the cash method of accounting. Otherwise, a farming trade or business is not prohibited from the use of the cash method of accounting as a result of changes made in the Tax Reform Act of 1986.

Explanation of Provision

The use of the cash method of accounting would be denied to any entity engaged in the trade or business of farming with average annual gross receipts in excess of $25 million, regardless of whether the entity meets the family farm exception. Average annual gross receipts would be determined by averaging the gross receipts of the entity (or related and predecessor entities) for the previous three taxable years.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987. The adjustment required by the change in method of accounting would be credited to a suspense account. The amount in the suspense account would be taken into income in the year in which the entity first failed to meet the terms of the family farm exception or reduced in size.

5. Require Current Accrual of Market Discount on Bonds

Present Law

In general, present law does not require current accrual of market discount, which is the economic equivalent of interest, by the holder of a bond. Thus, a taxpayer who purchases a bond after original issue at a price less than its face amount (or adjusted issue price in the case of a bond originally issued at a discount) does not, absent an election, include in income any portion of the discount prior to the redemption or other disposition of the bond. Current accrual is generally required, however, with respect to original issue discount.

Explanation of Provision

Market discount on a bond would be includible as interest income by the holder of the bond as such discount accrued. The amount of discount includible in a given taxable year would be computed using a simplified method (e.g., discount would be assumed to accrue on a straight-line basis), unless the holder elected to use the economic accrual method.

Effective Date

The provision would be effective for bonds acquired after October 13, 1987.

6. Amortization of Customer Base Intangibles

Present Law

No depreciation or amortization deductions are allowed with respect to property that is not a wasting asset or whose useful life cannot be estimated with reasonable accuracy. Such assets include goodwill and going concern value.

Taxpayers frequently take the position that a substantial portion of the purchase price of a business is allocable to assets that represent the value of the existing customer base and are said to have a determinable useful life as the customer base erodes. Evidence of continuing replacement of the customer base is often disregarded. In addition, the costs of such replacement are often not capitalized but are deducted currently. Such assets include, for example, customer and subscription lists; patient or other client records; the existing "core" deposits of banks; insurance in force in the case of an insurance company; advertising relationships and customer or circulation base in the case of a broadcast or newspaper business; other contracts or relationships reflecting the value of the customer base; and existing market share in the case of any business. Some taxpayers also deduct the cost of purchasing certain franchises or other assets with an indeterminate useful life, based on other interpretations of existing Code provisions, (i.e., a provison dealing with the treatment of certain lump-sum payments to a franchisor or trademark or trade name transferor who retains certain rights).

Explanation of Provision

The provision would clarify that amortization, depreciation or similar deductions are denied for intangible assets that are renewing or for any intangible assets with an indeterminate useful life. Deductions for intangible assets representing the value of the existing customer base or market share would be denied.

Effective Date

The provision would apply to acquisitions after October 13, 1987, unless pursuant to a binding written contract on that date.

7. Repeal of Vacation Pay Reserve

Present Law

Under present law, an accrual-method taxpayer generally is permitted a deduction in the taxable year in which all of the events have occurred that determine the fact of a liability and the amount thereof can be determined with reasonable accuracy. Nonetheless, in order to ensure the proper matching of income and deductions in the case of deferred benefits for employees (such as vacation pay earned in the current taxable year, but paid in a subsequent year), an employer generally is entitled to claim a deduction in the taxable year of the employer in which ends the taxable year of the employee in which the benefit is includible in gross income. Consequently, an employer generally is entitled to a deduction for vacation pay in the taxable year of the employee for which the pay (1) vests (if the vacation pay plan is funded by the employer) or (2) is paid and for amounts which vest or are paid within 2-1/2 months after the end of the employer's taxable year. Under a special rule, an employer can elect to deduct an amount representing a reasonable addition to a reserve account for vacation pay earned by employees before the close of the current year and paid by the close of that year or within 8-1/2 months thereafter.

Explanation of Provision

The special rule that permits taxpayers a deduction for additions to a reserve for vacation pay would be repealed. Under this proposal, deductions for vacation pay would be allowed in any taxable year for amounts paid, or funded amounts which vest, during the year or within 2-1/2 months after the end of the year.

Effective Date

The provision would apply to taxable years beginning after December 31, 1987.

B. Partnership Provisions

1. Treatment of Certain Limited Partnerships

Present Law

Entity classification.--Treasury regulations distinguishing partnerships from corporations currently have the effect that an association is not treated as a corporation (rather than a partnership) for Federal income tax purposes unless it has more than two corporate characteristics. The relevant corporate characteristics are: (1) continuity of life, (2) centralization of management, (3) liability for corporate debts limited to corporate property, and (4) free transferability of interests. There is no general rule for distinguishing partnerships from corporations on the basis of whether or not the entity conducts active business activities.

Treatment under the passive loss rule.--Under present law, deductions from passive trade or business activities (within the meaning of the passive loss rule), to the extent they exceed income from such passive activities, generally may not be deducted against other income. Passive income does not include income such as interest and dividends from the holding of stocks and bonds, etc. (portfolio income"). A limited partnership interest is treated as a passive activity and the income is not treated as portfolio income. Thus, except to the extent that Treasury may prescribe in regulations, income from limited partnerships may be offset by passive losses from other sources.

Unrelated business income.--Tax-exempt organizations generally are subject to tax on unrelated business income. This generally includes income from any unrelated business that the organization conducts, but excludes certain rental and other income. Generally, a partner's distributive share of income from a partnership retains the same character as in the hands of the partnership (e.g., a partner's distributive share of partnership income includes his share of partnership rental income).

Partnership level audits and compliance.--Present law provides for partnership-level audit of partnership items, but generally does not provide for collection of partners' tax liability or other compliance measures at the partnership level.

Explanation of Provisions

Entity classification.--Publicly traded limited partnerships that engage in active business activities (as defined for this purpose) would be treated as corporations for Federal income tax purposes. Publicly traded partnerships

would include those whose interests are traded on existing exchanges (including over the counter) and those in which a market is effectively made.

Treatment under the passive loss rule.--Losses and deductions of publicly traded limited partnerships that are not treated as corporations would be suspended at the partner level and could be used against income from that partnership with a carryforward mechanism. Limited partners' net income from the partnership would be treated as portfolio income to the partners under the passive loss rule.

Unrelated business income.--Tax-exempt organizations' distributive shares of income from any publicly traded limited partnership (that is not treated as a corporation for Federal income tax purposes) would be treated as unrelated business taxable income without regard to the underlying character of the income.

Partnership level audits and compliance.--Collection of partners' tax liability, and related measures for simplifying the administration of partnership level audits, would be imposed for publicly offered partnerships (including those required to file a notice under applicable securities rules).

Study of partnership entity classification.--A study would be conducted of the issue of treating publicly traded limited partnerships (and other partnerships that significantly resemble corporations) as corporations for Federal income tax purposes, including the issues of disincorporation and of opportunities for avoidance of the corporate tax. The study would be due January 1, 1989.

Effective Dates

Entity classification.--The entity classification provision would be effective with respect to partnerships formed or substantially expanded (or whose activities are substantially changed) after the date of committee action, or that become publicly traded and engage in active business activities after October 13, 1987. The provision would apply to all publicly traded active limited partnerships for taxable years beginning after December 31, 1994.

Treatment under the passive loss rule.--The treatment of net income from publicly traded limited partnerships as portfolio income would be effective as if enacted with the passive loss rule, i.e., for taxable years beginning after December 31, 1986.

Unrelated business income.--The treatment of partnership income of tax-exempt organizations would be effective for income from partnership interests acquired (including by contribution) after October 13, 1987.

Partnership level audits and compliance.--The provisions would be effective for taxable years beginning after December 31, 1987.

2. Treatment of Tax-Exempt Partners

Present Law

Under present law, partnership income, gain, loss, deduction or credit (or items thereof) may be allocated under the partnership agreement, but if the allocation does not have substantial economic effect, then the partner's share is redetermined in accordance with his interest in the partnership.

Under present law, tax-exempt organizations generally are subject to tax on unrelated business income. In general, income from debt-financed property is treated as unrelated business income. An exception from the unrelated business income tax is provided, in the case of debt-financed real property, provided the property is not leased back to the seller and certain other requirements are met, even if, at the same time, income can be allocated to tax-exempt partners and losses to taxable partners.

Explanation of Provision

The exception from unrelated business income treatment in the case of debt-financed real property would apply where the property is held by a partnership including tax-exempt partners, only if partnership allocations to the organization are consistently the same for all items, and have substantial economic effect.

Effective Date

The provision would be effective for debt-financed property acquired after (and acquisition debt on such property incurred after) October 13, 1987, unless the property was acquired pursuant to a binding written contract in effect on that date.

D. Mergers, Acquisitions and Corporate Transactions

1. Reduction of Tax Avoidance in Certain Corporate Dispositions

Present Law

Gains on certain distributions to a controlling corporate shareholder (an 80-percent distributee) are not taxed to the distributing corporation in a liquidation. By contrast, a nonliquidating distribution to such a shareholder causes the distributing corporation to recognize gain, though the gain would be deferred if the two corporations were filing consolidated returns until a disposition of the distributed property or certain other events. Certain divisive distributions of corporate stock are also tax-free to the distributing corporation. A sale of stock of a subsidiary to a related corporation is "deemed" to be a dividend, in some instances producing tax results more favorable than an actual sale or an actual dividend.

Explanation of Provision

The provision would generally treat liquidating distributions to an 80-percent corporate distributee that are not taxed under present law in the same manner as nonliquidating distributions. Similar rules would apply to foreign corporations.

Gain would specifically be deferred in the case of a liquidating distribution to a parent corporation filing a consolidated return with the distributing corporation, until triggered by a subsequent disposition or certain other events described in the consolidated return regulations. Certain rules for dispositions, including intragroup divisive stock distributions, and essentially equivalent transactions, and the deemed dividend rules for corporations would be modified so that the results are not more favorable than an actual dividend. Similar rules would apply to foreign corporations.

Effective Date

The provision would be effective for distributions after October 13, 1987.

2. Debt Financing and Corporate Acquisitions

Present Law

In general, corporate earnings distributed as dividends on equity are taxed at both the corporate level (when earned by the corporation) and at the shareholder level (when distributed). By contrast, corporate earnings distributed in the form of interest on corporate debt bear no corporate-level tax because interest is deductible. The Code thus creates a tax incentive to replace equity financing with debt financing to the extent this can reduce corporate taxes.

Section 279 of the Code denies corporate interest deductions on certain indebtedness incurred to acquire stock or substantially all the assets of another corporation. In general, that section denies a deduction for interest exceeding $5 million on certain corporate acquisition indebtedness. Because the restrictions of this provision can be fairly easily avoided, it does not as a practical matter effectively restrict the substitution of debt for equity in an acquisition.

Explanation of Provision

Deductions generally would be denied for interest exceeding $5 million a year on debt directly or indirectly supporting either (1) the acquisition of 50 percent or more of the stock of another corporation or (2) the redemption of 50 percent or more of the issuer's stock.

Effective Date

The provision would be effective for acquisitions or redemptions after October 13, 1987. Exceptions would be provided for transactions pursuant to a binding written contract, board action, shareholder approval, letter of intent, or tender offer, or public announcement to shareholders in effect on that date and at all times thereafter, provided the acquisition or redemption is completed before January 1, 1989.

3. Corporate Raider Tax Act

Present Law

Gain on the sale or exchange of corporate stock is taxed at regular tax rates; for 1987, a special lower capital gains rate may apply in certain circumstances.

A buyer of a controlling interest in corporate stock is not generally required to be treated as if the acquired corporation had sold all of its underlying assets, though a buyer may elect such treatment. Requiring the buyer to treat a stock purchase as such an underlying asset sale can result in significant additional corporate level tax.

Corporate earnings distributed in the form of interest on corporate debt bear no corporate-level tax because interest is deductible.

Explanation of Provision

A person who has made or threatened a hostile tender offer would be subject to an additional 50-percent non-deductible excise tax on "greenmail" gain on stock held less than two years that is redeemed by the company.

The acquisition of 80 percent or more of the stock of a company would be treated as if the corporation had sold all of its underlying assets in the hands of the purchaser, if any significant portion of the stock was acquired pursuant to a hostile offer.

No interest deduction would be allowed for indebtedness incurred to acquire stock or assets of a corporation if 20 percent or more of the stock was acquired in a hostile purchase.

Effective Date

The additional 50-percent tax would apply to payments received after the date of enactment of the provision. The treatment as an asset acquisition in the hands of the purchaser would apply to acquisitions after the date of enactment of the provision. The denial of interest deductions would apply to debt incurred after the date of enactment of the provision.

4. Modify Computation of Earnings and Profits for Intercorporate Dividends and Basis Adjustments (Overrule Woods Investment Co. Case)

Present Law

In some cases, a corporation can sell stock of a subsidiary for an economic profit without paying tax. This is due to the operation of the consolidated return regulations, which the Tax Court held it must follow in the case of Woods Investment Co. v. Commissioner, 85 T.C. 274 (1985). Those regulations produce this result because they have never been amended to accommodate the impact of certain statutory changes to the definition of earnings and profits that were enacted for other purposes (to assure that individual shareholders could not avoid tax on distributions). In some cases involving accelerated depreciation, a benefit similar to the Woods result might still be obtained outside of consolidation, because a 1984 Code provision did not cover accelerated depreciation.

Explanation of Provision

In determining a parent corporation's basis in the stock of a subsidiary with which it files a consolidated return, the earnings and profits of the subsidiary would be determined without regard to the special adjustments otherwise required under the Code (thus, the excess of earnings and profits adjustments over taxable income would not be taken into account for this purpose). Earnings and profits for this purpose would not include any cancellation of indebtedness income of the subsidiary not taken into account in computing taxable income. Outside a consolidated return context, the provision enacted in 1984 would be expanded to include adjustments for accelerated depreciation.

Effective Date

The provision would apply to stock held on or acquired after October 13, 1987 (i.e., to dispositions after that date). The computation of gain or loss on such dispositons would be computed taking into account the principles of the amendment during the entire holding period of the stock.

5. Limit Consolidated Return Pass-Through

Present Law

Under present law, corporations may file consolidated tax returns if they are members of an affilated group of corporations. In general, a parent and a subsidiary corporation are members of an affiliated group for this purpose if the parent corporation owns stock of the subsidiary possessing at least 80 percent of the total voting power and value of all the subsidiary stock (excluding certain nonvoting preferred stock).

Under the consolidated return regulations, the consolidated tax return of a parent corporation and an affiliated subsidiary generally allows 100 percent of a subsidiary's losses to offset the parent's income, or, conversely, allows 100 percent of a subsidiary's income to be offset by the parent's losses, even though the parent may own less than 100 percent of the subsidiary's stock.

Explanation of Provision

If the affiliated group owns less than 100 percent of the stock of a subsidiary, the provision would deny consolidation of the percentage of the subsidiary's income or loss attributable to stock owned by nonmembers. All classes of stock would be counted for this purpose.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

6. Tax Loss Mergers and Acquisitions

Present Law

Generally, the Code prohibits the direct sale of tax benefits from one corporation to another.

Nevertheless, there are a number of acquisition techniques through which taxpayers may attempt to transfer or "cash out" tax benefits that could not otherwise be used.

Explanation of Provisions

Built-in depreciation would be subject to the built-in loss rules of section 382.

The loss carryforwards of a corporation in bankruptcy would be reduced by the full amount of the excess of the debt cancelled in the proceeding over the fair market value of the stock given to creditors in exchange for debt.

Loss corporations would be precluded from using their losses to shelter built-in gains of an acquired company recognized within 5 years of the acquisition.

Effective Date

The built-in depreciation and stock for debt provisions would apply to ownership changes (as defined for purposes of section 382) after October 13, 1987. The provision preventing sheltering and resale of built in gain assets would apply to acquisitions after October 13, 1987. Transition relief would be provided for transactions pursuant to a binding written contract in effect on that date and at all times thereafter.

7. Tax Benefited Transfers through Intercorporate Dividends Received Deduction (Including Preferred Stock Loss Transfers)

Present Law

Under present law, corporations owning less than 80 percent of the stock of a corporation are entitled to a deduction equal to 80 percent of the dividends received from a domestic corporation. (A 100 percent deduction may apply to dividends received by an 80-percent or more corporate parent).

Explanation of Provision

The 80-percent dividends received deduction for any corporation owning less than 80 percent of the stock of the distributing corporation would be reduced to 75 percent of the amount of the dividend.

The 80-percent dividends received deduction would be eliminated for dividends on stock that has certain non-stock characteristics--for example, nonvoting preferred or other stock that is not treated as stock for certain other purposes of the Code; or stock where the holder in substance (through any mechanism, arrangement, practice, or otherwise) has an enhanced likelihood of recovering the principal amount or a dividend level (whether from the issuer or on resale or otherwise), including but not limited to adjustable rate stock, auction rate stock, and stock where the holder in substance may have certain redemption or secured interest or similar aspects.

Effective Date

The reduction of the 80-percent dividends received deduction to 75-percent would apply to dividends paid after December 31, 1987.

The futher elimination of the present law 80-percent dividends received deduction for certain stock would apply to stock issued after October 13, 1987.

8. Limitations on Net Operating Loss Carryforwards of Corporations Following Worthless Securities Deduction By Shareholders

Present Law

A deduction is allowed for any loss sustained during the taxable year as a result of securities held by the taxpayer becoming worthless. It has been held that, notwithstanding the fact that a worthless stock deduction has been claimed by parent corporation with respect to stock of a nonconsolidated subsidiary, the net operating loss carryforwards of the subsidiary survive and may be used to offset future income of the subsidiary. Textron, Inc. v. United States, 561 F.2d 1023 (1st Cir. 1977).

Loss carryforwards of a corporation are limited if there is a more-than-50-percent change in the ownership of its stock during the relevant testing period. The amount of losses that may be used annually to offset post-change income of the corporation is equal to a prescribed rate of return on the net value of the corporation at the time of the change of ownership.

Explanation of Provision

If a worthless securities deduction is claimed by a shareholder of a loss company, the shareholder would be treated as having sold the stock to an unrelated person for purposes of applying the loss limitations of section 382. Thus, if such a deduction is claimed during the testing period by persons holding more than 50-percent of a loss corporation's stock, net operating loss carryovers of the corporation arising prior to the change generally could not be used to offset the corporation's post-change income.

Effective Date

The provision would apply to worthless securities deductions in taxable years beginning after December 31, 1987.

9. Denial of Graduated Tax Rates for Personal Service Corporations

Present Law

Under present law, beginning July 1, 1987, corporations are generally subject to a tax at the rate of 34 percent. However, for corporations with a taxable income below $335,000, graduated rates are provided. These rates are 15 percent on taxable income not over $50,000, and 25 percent on taxable income over $50,000 and not over $75,000, with the benefits of these lower rates phased out as taxable income increases from $100,000 to $335,000.

Explanation of Provision

The benefits of the graduated corporate rates would be denied to personal service corporations. A personal service corporation is a corporation substantially all the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and substantially all the stock of which is held by the employees performing services for the corporation.

Effective Date

The provision would apply to taxable years beginning after December 31, 1987.

10. LIFO Recapture on Conversion from C Corporation to S Corporation

Present Law

In general, gain realized when a C corporation liquidates is subject to corporate level tax. If a C corporation elects to convert to S corporation status and holds assets with a net unrealized "built-in gain" (that is, with a value in excess of basis) at the time of its conversion, the built-in gain is subject to a separate corporate-level tax to the extent it is realized within ten years after the conversion.

The Internal Revenue Service has stated that the inventory method used by a taxpayer for tax purposes shall be used in determining whether goods disposed of following a conversion to S corporation status were held by the corporation at the time of conversion. Thus, a C corporation using the last-in, first-out (LIFO) method of accounting for its inventory which converts to S corporation status will not be taxed on the built-in gain attributable to LIFO inventory to the extent it does not invade LIFO layers during the ten-year period following the conversion.

Explanation of Provision

A C corporation using the LIFO method which elects S corporation status would be required to include in income the LIFO recapture amount (that is, the excess of the inventory's value using a first-in, first-out (FIFO) flow assumption over its LIFO value on the date of the conversion) upon conversion.

Effective Date

The provision would apply to S elections made after October 13, 1987.

D. Minimum Tax Provisions: Increase Book and Adjusted Current Earnings Prefererence to 100 Percent

Present Law

Taxpayers are subject to an alternative minimum tax payable, in addition to all other tax liabilities, to the extent it exceeds the taxpayer's regular tax. The tax is imposed at a flat rate (20 percent for corporate taxpayers, 21 percent for othrs) on alternative minimum taxable income in excess of an exemption amount. Alternative minimum taxable income generally is the taxpayer's taxable income. increased or decreased by certain adjustments and preferences.

In the case of a corporate taxpayer, one-half of the excess of pre-tax book income of a corporation over other alternative minimum taxable income is a preference for taxable years beginning in 1987 to 1989. For taxable years beginning after 1989, three-fourths of the excess of adjusted current earnings over other alternative minimum taxable income is a preference.

Explanation of Provision

100 percent of the excess of book (for taxable years beginning before 1990) or adjusted current earnings (for taxable years beginning after 1989) over other alternative minimum taxable income would be a preference for corporate taxpayers.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

F. Foreign Tax Provisions

1. Income from Runaway Plants

Present Law

U.S. persons that conduct foreign operations through a foreign corporation generally pay no U.S. tax on the income from those operations until the foreign corporation pays a dividend to its U.S. owners. The foreign tax credit may reduce or eliminate the U.S. tax on those dividends, however.

Deferral of U.S. tax on income of a U.S. corporation's foreign subsidiary is not available for certain kinds of income, including "foreign personal holding company income" (such as interest and dividends, net gains from sales of stock and securities, and some rents and royalties), certain sales and services income, and certain other kinds of tax haven income.

Explanation of Provision

The provision would repeal deferral for (that is, impose current tax on) income from "runaway plants," that is, income that a U.S. corporation's foreign subsidiary earns from manufacturing goods for use or consumption in the United States. This income, as well as allocable interest and royalties paid by a foreign subsidiary, would be subject to a separate foreign tax credit limitation, so that, for example, foreign taxes imposed on other income could not offset the U.S. tax on this income. this separate limitation would apply not only to income that foreign subsidiaries of U.S. taxpayers earn, but also to similar income earned directly by U.S. taxpayers.

Effective Date

This provision would apply for taxable years beginning after 1987.

2. Treatment of South African Income

Present Law

Foreign tax credits and certain other benefits are denied with respect to income attributable to activities of the taxpayer conducted in certain foreign countries whose current governments support terrorism, do not have diplomatic relations with the United States, or are unrecognized by the United States. Countries that are currently on this list are Afghanistan, Albania, Angola, Cambodia, Cuba, Iran, Libya, North Korea, Syria, Vietnam, and South Yemen. The other denied benefits include deferral and cross-crediting of other countries' taxes against U.S. taxes on income from these countries.

The comprehensive anti-apartheid act of 1986 imposes certain measures on South Africa, including economic measures such as the termination of the U.S.-South Africa tax treaty, to undermine apartheid.

Explanation of Provision

The provision would subject South African operations to the same tax treatment currently given to operations in the countries listed above.

Effective Date

The provision would apply to taxable years beginning after December 31, 1987. The provision would terminate once the South African government had taken the steps that trigger termination of the measures of the anti-apartheid act to undermine apartheid.

F. Insurance Provisions

1. Minimum Tax Treatment of Mutual Life Insurance Companies

Present Law

In computing the corporate alternative minimum tax, 50 percent of the excess of the adjusted net book income of a taxpayer over the unadjusted alternative minimum taxable income of the taxpayer is included in income (the "book income" preference). Under the book income preference, mutual life insurance companies are not required to include in income the differential earnings amount, an amount included in their regular taxable income that is intended to take account of the deductibility of policyholder dividends that represent a return of company earnings. Stock companies do not include a differential earnings amount in their regular taxable income. Thus, mutual companies are likely to have a smaller difference between book income and alternative minimum taxable income than are stock companies, and consequently are less likely than stock companies to incur tax liability under the corporate alternative minimum tax.

Explanation of Provision

An adjustment would be added to the calculation of book income of mutual life insurance companies to include the differential earnings amount in their book income.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

2. Treatment of Investment Income of Foreign Insurance Companies

Present Law

In the case of a foreign life insurance company, any income from sources outside the United States that is attributable to its United States business is treated as effectively connected with the conduct of a United States trade or business and, thus, is subject to United States tax. In addition, present law requires that income effectively connected with the conduct of a life insurance business in the United States be increased by an imputed amount to the company, if its surplus held in the United States is insufficient in relation to a percentage of its total insurance liabilities on its United States business. The purpose of this imputation rule is to prevent foreign life insurance companies from artificially reducing the amount of investment income subject to tax in the United States.

Explanation of Provision

The rules for determining the amount of investment income that is effectively connected with the conduct of a life insurance business in the United States would be extended to foreign property and casualty insurance companies. In addition, the imputation rule would be strengthened to prevent foreign insurance companies from artificially decreasing the amount of investment income subject to tax in the United States.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

3. Treatment of Certain Insurance Syndicates

Present Law

Pursuant to a closing agreement between the IRS and the members of an insurance organization formed under the laws of the United Kingdom, these members are provided a three-year deferral of underwriting income or loss, consistent with the organization's traditional accounting method.

Explanation of Provision

In the case of a person who is a member of an organization formed under the laws of the United Kingdom to write insurance or reinsurance, the deferral currently allowed pursuant to the closing agreement would be prohibited. Income and loss would be subject to tax in the U.S. and would be calculated annually in accordance with the principles generally applicable to property and casualty insurance companies.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

4. Interest Rate Used in Computing Reserves for Life Insurance and Annuity Contracts

Present Law

Under present law, the discount rate in computing life insurance tax reserves is the prevailing State assumed interest rate (generally, the highest rate for computing insurance reserves under the state insurance laws of 26 or more States). By contrast, under present law, tax reserves for unpaid losses of property and casualty insurance companies are subject to discounting by applying the applicable Federal rate (AFR) of interest (specifically, the average of the applicable Federal mid-term rates for the most recent 60-month period beginning after July 31, 1986).

Explanation of Provision

The interest rate used in determining reserves for life insurance and annuity contracts would be the greater of (1) the prevailing State assumed interest rate or (2) the AFR.

Effective Date

The provision would apply to life insurance and annuity contracts issued after December 31, 1987.

G. Unrelated Business Income Tax (UBIT) on Net Investment Income of Trade Associations

Present Law

Dividends, interest, and other investment income earned by a tax-exempt organization generally are excluded from unrelated business income subject to the UBIT (unless derived from debt-financed property or certain controlled entities).

However, in the case of social clubs, VEBAs, and certain other mutual benefit organizations, the UBIT applies to all gross income--including investment income--other than "exempt function income," such as membership receipts. The legislative history of this rule indicates that the Congress concluded that if investment income could be received tax-free, the members of social clubs, VEBAs, etc. would receive tax-free personal benefits.

Explanation of Provision

The investment income of tax-exempt organizations described in Code section 501(c)(6) (generally referred to as "trade associations") would be subject to the UBIT except to the extent set aside for charitable purposes, and except for gain on certain dispositions of assets used in performing the organization's tax-exempt purposes.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1987.

H. Pensions: Modify Full Funding Limitation

Present Law

Under present law, subject to certain limitations, an employer may make deductible contributions to a qualified defined benefit pension plan up to the full funding limitation. The full funding limitation is defined as the excess of (1) the accrued liability under the plan for projected benefits over (2) the plan assets. Projected benefits, unlike accrued benefits, are the benefits that are projected to be earned by normal retirement age, rather than the benefit accrued as of the close of the year.

If a defined benefit plan is terminated, the employer's liability to plan participants does not exceed the plan's termination liability (i.e., the liability for benefits determined as of the date of the plan termination). However, contributions to a plan with assets significantly in excess of termination liability may be deductible because the full funding limitation is determined on the basis of projected benefits.

Explanation of Provision

A contribution to a defined benefit pension plan would not be deductible to the extent that (1) the plan's assets exceed the present-law full funding limitation, or (2) after the contribution, the plan's assets exceed 150 percent of the plan's termination liability.

Effective Date

This provision would be effective for years beginning after December 31, 1987.

III. EMPLOYMENT AND EXCISE TAXES; USER FEES

A. Employment Taxes

1. Expand Employer Share of FICA Tax to Include All Cash Tips

Present Law

The FICA taxes imposed on an employee and the employee's employer generally are equal. The employer is responsible for withholding the employee's share of the tax from the employee's wages and remitting the tax, together with the employer's share of the tax, to the Internal Revenue Service.

In the case of tips, however, an employee is subject to the employee's share of FICA tax, but the employer is not. The employer is responsible for FICA taxes only to the extent (if any) the Federal minimum wage rate exceeds the actual wage rate paid by the employer. Any tips received in excess of the minimum wage are not subject to the employer's portion of the tax. The employee's earnings record on which benefits are ultimately based reflects the full amount of reported tips, even though less than the full tax rate may be paid by the employer on those wages.

Explanation of Provision

Under the provision, all cash tips would be included within the definition of wages for purposes of the employer's share of FICA taxes. Thus, employers would be required to pay FICA taxes on the total amount of cash tips (up to the Social Security wage base).

Effective Date

The provision would be effective January 1, 1988.

2. Extend FUTA Repayment Tax

Present Law

Under present law, the gross FUTA tax rate of 6.2 percent of the first $7,000 in wages paid to an employee consists of a permanent component of 6.0 percent and a temporary component of 0.2 percent. (The net FUTA tax is 0.8 percent after taking into account the 5.4 percent credit for State unemployment taxes.)

The temporary 0.2-percent tax component is scheduled to expire at the beginning of the first year following the year in which the advances from general revenues are repaid. The advances were fully repaid in 1987. As a result, for the year beginning January 1, 1988, the FUTA tax rate will be 6.0 percent (0.6 percent after taking into account the 5.4 percent credit for State unemployment taxes).

Explanation of Provision

The temporary FUTA tax component of 0.2 percent would be extended for three years through 1990. In addition, the ceiling on funds retained in the Extended Unemployment Compensation Account (EUCA) and the Federal Unemployment Account (FUA) would be raised in each account to 0.375 percent of covered wages. Half of the additional revenue would be retained in EUCA and the other half in FUA. This would allow the buildup of reserves to cover future outlays. If these reserves are insufficient to cover outlays, interest would be charged on any new general fund advances to EUCA and FUA.

Effective Date

The provision would be effective for wages paid after December 31, 1987.

B. Excise Taxes

1. Telephone Excise Tax: 3-Year Extension at 3 Percent

Present Law

A 3-percent excise tax is imposed on amounts paid for local and toll (long-distance) telephone service and teletypewriter exchange service. The tax is scheduled to expire after December 31, 1987.

Explanation of Provision

The telephone excise tax would be extended at 3 percent for 3 years, 1988-1990, after which it would expire.

Effective Date

The provision would be effective on January 1, 1988.

3. Repeal Highway Excise Tax Exemptions for Buses

Present Law

Revenues from excise taxes on motor fuels and tires are deposited in the Highway Trusts Fund. Receipts of the Trust Fund are used to finance expenditures which are authorized from the Highway Trust Fund. Exemptions from these excise taxes are provided for fuels purchased by private and public bus operators.

Private and public bus operators are exempt from the excise tax on tires. Intercity common carrier buses, school buses, and qualified local buses are exempt from the 9-cents-per-gallon highway taxes on gasoline and special motor fuels. School buses and qualified local buses are also exempt from the 15-cents-per-gallon diesel fuel tax. In addition, private intercity buses receive a 12-cents-per-gallon refund (or credit) of the 15-cents-per-gallon highway diesel fuel tax. No exemption is available for buses engaged in transportation that is not scheduled and is not along regular routes, unless the seating capacity of the bus is at least 20 adults (not including the driver).

Explanation of Provision

The exemptions for private bus operators from excise taxes which are deposited into the Highway Trust Fund would be repealed.

Effective Date

The provision would be effective on January 1, 1988.

3. Collect Diesel Fuel and Special Motor Fuels Taxes on Sales to Retailer

Present Law

The diesel fuel and special motor fuels excise taxes generally are imposed on the sale of the taxable fuel by a retail dealer to the ultimate consumer of the fuel. Under an exception, retail dealers may elect to have wholesale distributors collect and pay the diesel fuel tax when the fuel is sold to the retailer.

Explanation of Provision

The election to collect the diesel fuel excise tax on sales by wholesale dealers would be made mandatory for all sales. The special motor fuels excise tax likewise would be imposed on sale of the fuel by a wholesale distributor.

Effective Date

The provision would be effective on January 1, 1988.

C. Certain New User Fees

1. Internal Revenue Service

Present Law

The Internal Revenue Service (IRS) currently does not charge taxpayers for issuing letter rulings, determination letters or opinion letters. In 1984, the IRS issued 106,613 applications and ruling requests from tax-exempt organizations. The IRS also issued 34,246 letter rulings in response to taxpayer's requests during 1984.

Explanation of Provision

The IRS would charge a user fee for letter rulings, determination letters, opinion letters and other similar written statements requested by individuals or organizations.

Effective Date

The provision would apply to requests filed (1) on or after the first day of the second calendar month that begins after the date of enactment of the Act and (2) before October 1, 1990.

2. Bureau of Alcohol, Tobacco, and Firearms

Present Law

The Treasury Department's Bureau of Alcohol, Tobacco, and Firearms (BATF) collects licensing fees and excise taxes on various types of alcohol and tobacco products and on firearms. These fees and taxes are collected pursuant to the Internal Revenue Code, the Federal Alcohol Administration Act, and the Federal Gun Control Act. In addition, occupational taxes are imposed on persons engaged in certain alcohol- and firearms-related businesses and permit requirements apply to these and other persons engaged in alcohol-, tobacco-, and firearms-related businesses.

Explanation of Provisions

Producers and manufacturers

The present producer/manufacturer occupational taxes would be increased to annual amounts of $1,000 per place of business for producers of all taxable alcoholic beverages (distilled spirits, wine, and beer), manufacturers of all taxable tobacco products, and for firearms producers.

A special rate of $500 per year would apply to businesses (including a controlled group) having gross receipts of less than $500,000 in the preceding taxable year.

Dealers

The present firearms dealer occupational tax would be increased to $500 per year per place of business.

The present alcoholic beverage wholesale dealer occupational taxes would be combined and imposed at an increased rate of $500 per year per place of business.

The present alcoholic beverage retail dealer occupational taxes would be combined and imposed at an increased rate of $250 per year per place of business. The present occupational taxes on limited retail dealers would be repealed. The retail dealer occupational tax is extended to all persons required to acquire permits for tax-free use of distilled spirits under section 5271.

The three occupational tax rates for persons receiving drawbacks of the distilled spirits tax for spirits used in nonbeverage products would be combined and increased to $500 per year per place of business.

Effective Date

The provisions would be effective on January 1, 1988.

3. Customs Service

Present Law

As enacted in the Omnibus Budget Reconciliation Act of 1986, an ad valorem user fee is applied to all formal entries of merchandise imported for consumption in the amount of 0.22 percent during fiscal year 1987, dropping to the lesser of 0.17 percent or the rate which will provide revenue equal to the appropriated level of Custom's commercial operations in fiscal year 1988 and expiring September 30, 1989. The fee does not apply to articles classifiable in schedule 8 of the Tariff Schedules (including products containing U.S. components which are classifiable in item 807.00 of the Schedules).

Explanation of Provision

The customs user fees provisions would be amended in the following respects:

(1) The schedule 8 exemption would be modified so that the foreign value of item 806.30/807 imports would be subject to the fee (periodic reporting would be allowed for articles which are totally duty-free);

(2) The fees would be extended for one additional year;

(3) The fee level of 0.22 percent would be maintained for one additional year at which time it would be adjusted to the lesser of 0.22 percent or the rate which would provide revenue approximating the appropriated level of Customs' commercial operations;

(4) A provision would be added precluding Customs from collecting an annual fee from operators of foreign trade zones and bonded warehouses in addition to the per-entry customs user fee;

(5) A clarification would be made to the customs overtime provision to preclude OMB from apportioning such funds (Customs would be precluded from arbitrarily reducing "regular" (i.e., non-overtime) work hours);

(6) Clarifying language would be added requiring customs services to be "adequately provided" (including preclearance operations) without additional charges other than user fees;

(7) A GAO study would be requested relating to Customs' centralized inspection and examination procedures; and

(8) An extension would be made in the time period for filing requests for refunds of user fees paid by vessel

operators who had paid for 10 or more entries before the 10-trip ceiling on fees was established in the Tax Reform Act of 1986.

Effective Date

This provision would be effective upon date of enactment.

IV. OTHER REVENUE-INCREASE PROVISIONS

A. Targeted Jobs Tax Credit

Present Law

There is no provision in present law specifically disallowing the targeted jobs tax credit to an employer when members of a targeted group, who otherwise qualify under section 51, are hired to perform employment services in a labor dispute situation.

Explanation of Provision

Under the provision, an employer would not be entitled to the targeted jobs tax credit with respect to certain wages if the employer's plant or facility is involved in a strike or lockout. Specifically, the credit would not be available for wages paid to a targeted-group individual who performs the same or substantially similar services as those of employees participating in or affected by the strike or lockout.

Effective Date

This provision would apply to amounts paid or incurred on or after January 1, 1987 for services rendered on or after such date.

B. Compliance Provisions

1. IRS Funding for Better Compliance

Present Law

The President's Budget Proposal for fiscal year 1988 recommended that $5,071,850,000 in spending authority be made available for the Internal Revenue Service. This would be an increase of $584,058,000 over the President's request for fiscal year 1987 (including supplemental appropriations for retirement contributions). The Treasury, Postal Service and General Government Appropriations Act, 1988 (passed by the House on July 15, 1987) provides the same amount to the IRS as does the President's Budget Proposal, except that it also provides an additional $55 million for taxpayer services.

The Budget Resolution for fiscal year 1988 recommends additional funding above the freeze level of $547 million for the IRS, targeted to increased audit, compliance, and investigation efforts. The report of the Committee on the Budget states that these increased amounts are estimated by CBO to increase revenues by $1.85 billion in 1988, and $14 billion between 1988 and 1992.

Explanation of Provision

A Sense of the Congress Resolution would be included, stating that (1) Congress should increase outlays for the IRS for fiscal year 1989 by $.7 billion and for fiscal year 1990 by $.8 billion; (2) IRS should offer improved taxpayer assistance and enforcement efforts by using these increases in areas recommended by the "Dorgan Task Force Report;" (3) the IRS should be one of the first Federal agencies to utilize the new Gramm-Rudman option of a two-year budget cycle and (4) that increased funding should be provided for compilation and analysis of statistics of income and research. Also, the IRS would be mandated to study the extent of the tax gap and the measures that could be undertaken to decrease the tax gap. The study would be required to utilize more current data than has been utilized recently.

2. Escheat of Refunds

Present Law

Some taxpayers may not claim their tax refunds for a variety of reasons. Although under present law unclaimed refunds remain in the General Fund of the Treasury, no provision of the Code requires that unclaimed Federal tax refunds escheat (revert) to the Federal Government. Some States have sued the Federal Government, asserting that unclaimed Federal tax refunds escheat to the State. If the States win these cases, the Federal Government would be required to pay these amounts out of the General Fund of the Treasury to the States.

Explanation of Provision

The Code would be amended to require that unclaimed Federal tax refunds remain in the General Fund of the Treasury.

Effective Date

This provision would be effective on the date of enactment.

C. Debt Collection: 3-Year Extension

Present Law

Certain Federal agencies are authorized to notify the IRS that a person owes a past due, legally enforceable debt to the agency. The IRS then must reduce the amount of any tax refund due the person by the amount of the debt and pay that amount to the agency. This program expires after December 31, 1987.

Under IRS regulations, the program only affects refunds due individuals, not corporations.

Explanation of Provision

Under the provision, the Federal debt collection program would be extended for three years for all Federal agencies. Also, the program would be expanded to cover corporate, as well as individual, debts owed to Federal agencies.

The IRS and GAO would be required to report on the effectiveness of the program and its effect on voluntary tax compliance.

Effective Date

The provision would be effective on January 1, 1988, and would expire after December 31, 1990.

D. Estimated Taxes

1. Estimated Tax Penalty Relief for 1987

Present Law

Individuals

The 1986 Act increased from 80 to 90 percent the percentage of the current year's tax liability that must be paid in order to avoid an estimated tax penalty for taxable years beginning after December 31, 1986.

Corporations

Present law does not give explicit authority to the Treasury to provide alternative estimated tax rules for corporations.

The Treasury has issued regulations, applicable to estimated tax payments due before July 1, 1987, that permit corporations to base those estimated payments on 120 percent of 1986 taxable income with certain modifications.

Explanation of Provisions

Individuals

The increase in the required percentage of the current year's liability that must be paid as estimated taxes in order to avoid a penalty would be delayed for one year. In addition, employers would be required to make newly filed Forms W-4 effective on a more timely basis.

Corporations

Two safe harbors would be provided for estimated tax payments due before July 1, 1987. First, all corporations, including large corporations, would be permitted to base those estimated tax payments on 100 percent of the 1986 tax liability. Second, statutory authorization would be provided for the safe harbor provided in the Treasury regulations.

2. Corporate Estimated Tax Reform

Present Law

Under present law, a corporation that fails to pay an installment of estimated income tax on or before the due date generally is subject to a penalty computed at the rate of interest for tax underpayments. The penalty may not be waived. The penalty is computed by applying the underpayment interest rate to the amount of the underpayment of the installment for the period of the underpayment. The amount of the underpayment is the difference between the payments made on or before the due date of each installment and 90 percent of the total tax shown on the return for the year, divided by the number of installments that should have been made. The penalty on underpayments of estimated tax that are between 80 percent and 90 percent of the actual tax due is imposed at three-quarters of the full rate.

There are three exceptions to the penalty. No penalty is imposed upon a corporation if total tax payments for the year equal or exceed installments based on (1) the preceding year's tax liability, if a return showing a liability for tax was filed for the preceding year; (2) the tax computed by using the facts shown on the prior year's return under the current year's tax rates; or (3) 90 percent of the taxes which would be due if certain income already received during the current year was annualized. Large corporations may not use exceptions (1) and (2) described above. A large corporation is defined as a corporation having at least $1 million of taxable income in any of the three prior taxable years. No penalty is imposed where the tax is less than $40.

Explanation of Provisions

The provision would consolidate all the corporate estimated tax rules into one section of the Code, similar to the provision enacted for individuals in 1984. Also, several modifications would be made to present law.

The underpayment penalty with respect to any installment would apply to the difference between payments made by the due date of the installment and the lesser of an installment based on (1) 90 percent of the tax shown on the return; or (2) 100 percent of the tax shown on the preceding year's return. As under present law, exception (2) would generally not apply to a large corporation, except that a large corporation could use that exception for purposes of making its first estimated payment for any taxable year. In determining whether a corporation is a large corporation because it's taxable income exceeds $1 million, net operating loss and capital loss carryforwards and carrybacks would be disregarded.

In addition, the full rate of the penalty would be imposed with respect to any payment only to the extent the total payments for the year up to the required installment are below 90 percent of the taxes which would be due if the income already received during the current year was placed on an annual basis. Any reduction in a payment resulting from using the annualization exception must be made up in the subsequent payment if the corporation does not use the annualization exception for that subsequent payment.

Finally, no penalty would be imposed if the tax for any taxable year is less than $500.

Effective Date

This provision would be effective for taxable years beginning after December 31, 1987.

E. Tax-Exempt Bond Provisions

1. Limitation on Issuance of Tax-Exempt Bonds by Indian Tribes

Present Law

Indian tribal governments in general are treated like State governments under the Internal Revenue code; however, tribal governments may issue tax-exempt bonds only for "essential governmental purposes." They may not issue private activity bonds.

IRS regulations define "essential governmental purposes" to include projects for which federal assistance could be provided under the terms of legislation governing federal assistance to Indian tribes. These regulations have permitted issuance of tax-exempt bonds for the acquisition of off-reservation enterprises. (Such issuance may, however, violate the arbitrage provisions of the 1986 Act preventing the issuance of tax-exempt bonds for investment-type property.)

Explanation of Provision

The authority of Indian tribes to issue tax-exempt bonds would be expressly limited to those purposes, other than private activity bonds, for which tax-exempt bonds generally are issued by State or local governments.

Effective Date

The provision would apply to bonds issued after October 13, 1987.

2. Limit on Issuance of Tax-Exempt Bonds to Acquire Existing Output Facilities

Present Law

State and local governments may issue tax-exempt bonds to finance the construction of publicly owned and operated output facilities such as electric generating and transmission systems and gas distribution systems. These governments may also use tax-exempt bonds to acquire the existing assets of investor-owned utilities including nuclear plants which may never be placed in service.

Explanation of Provision

The use of tax-exempt bonds directly or indirectly to acquire the assets of or interests in existing output facilities, within the meaning of Code section 141(b)(4) would be subject to the private activity bond volume cap.

Effective Date

The provision would be effective for bonds issued after October 13, 1987.

F. Farm Water Subsidies as Gross Income

Present Law

The Federal government makes available to certain taxpayers water from reclamation and irrigation projects for agricultural purposes. Pursuant to the Reclamation Reform Act of 1982, this water is required to be provided at "full cost" in certain situations. In other situations, the water may be priced other than at full cost. The difference between the full cost of the water and the amount charged the taxpayer is not considered an item of income for Federal income tax purposes.

Explanation of Provision

Include in income the value of any water subsidies that are in violation of present Federal limitations, or limitations that may be adopted in the future, on water subsidies. No deduction would be allowed for any amount included in income under this provision.

Effective Date

The provision would be effective for water delivered to the taxpayer after December 31, 1987.

PART TWO: TECHNICAL CORRECTIONS

The Committee will consider the provisions of H.R. 2636 ("Technical Corrections Act of 1987"),[1] as well as the additional technical amendments proposed by Chairman Rostenkowski.[2]

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[1] For a description of H.R. 2636, see Joint Committee on Taxation, Description of the Technical Corrections Act of 1987 (H.R. 2636 and S. 1350) (JCS-15-87), June 15, 1987).

[2] For a description of these amendments, see Joint Committee on Taxation, Description of Amendments by Chairman Rostenkowski to H.R. 2636 (Technical Corrections Act of 1987) (JCX-14-87), October 14, 1987.

PART THREE: MISCELLANEOUS TAX PROVISIONS

Title numbers refer to titles of the Tax Reform Act of 1986.

Title I. Individual Income Tax Provisions

1. Capital loss carryforward.--The provision of prior law limiting capital losses to taxable income would be reinstated.

2. Eligibility for earned income credit.--A taxpayer would not be ineligible for the earned income tax credit merely because AFDC constitutes more than half the support of the taxpayer's children.

3. Graduate tuition reduction.--Under present law, the amount of tuition reduction provided to a graduate teaching or research assistant is includible in gross income to the extent constituting compensation for services (sec. 117(c)); amounts in excess of compensation may qualify for exclusion pursuant to sections 117(d) and 127. Under the provision, the total amount of qualified tuition reduction granted to a graduate student engaged in teaching or research activities for a college or university would be eligible for exclusion (up to the amount of the student's tuition fees) under section 117(d), effective for taxable years beginning after December 31, 1986.

4. Foreign lecturers.--Under present law, grants or awards received by nonresident aliens for lecturing or teaching at U.S. educational institutions are subject to gross withholding at a 30-percent rate but to U.S. tax on a net income basis. The provision would provide 14-percent withholding for such lecturers.

5. Mutual fund shareholders.--Miscellaneous itemized deductions generally are allowable only to the extent exceeding two percent of the taxpayer's adjusted gross income. Under present law, the two-percent floor applies with respect to indirect deductions through mutual funds. Under the provision, the two-percent floor would not apply to indirect deductions with respect to publicly offered mutual funds, effective for taxable years beginning after December 31, 1986.

6. Ticket service charges.--Under the provision, the amount otherwise allowable as a deduction for entertainment ticket costs would be limited to the face value of the ticket plus any service charge resulting from mail, telephone, and computer orders, delivery charges, and commissions. However, the amount of service charge that could be thus taken account could not exceed the greater of (1) 10-percent of the price of the ticket or (2) $5.00. The total of the ticket face

value and the allowable service charge then would be subject to the 20-percent reduction rule.

7. Rural letter carriers.--Rural letter carriers of the U.S. Postal Service would be allowed to deduct automobile expenses at 150 percent of the standard mileage rate, i.e., 33.75 cents instead of 22.5 cents in 1987, but could not claim both depreciation and the special rural-carrier standard mileage deduction. This provision would apply to taxable years beginning after December 31, 1986.

8. Courier plane seats.--Under the provision, the transportation of cargo by air and the transportation of passengers by air would be treated as the same service for purposes of the exclusion from income for no-additional-cost services (sec. 132(b)).

9. Commission on Children.--A National Commission on Children would be established for a one-year period to investigate and report on the current state of children in the United States. The report would cover what is proper care of children, how well present programs meet those needs, and what must be done to improve the status of children. The Commission is to include in its considerations the impact of provisions in the Internal Revenue Code.

10. Transit passes.--Under the provision, the first $15 of transit passes provided by an employer to an employee in a month would be excludable from gross income.

11. Rollover of gain.--In general, taxpayers (including a married couple filing jointly) may avoid recognition of gain on sale of their principal residence if the taxpayer reinvests the sales price of the old residence in a new principal residence within a specified time period. Under the provision, the nonrecognition rule is extended to apply where (1) one spouse dies after the date of selling the old residence but before purchasing the new residence, and (2) the surviving spouse purchases a new principal residence within the specified time period. The provision applies with respect to sales of old residences after December 31, 1984. In addition, the special nonrecognition rule that applies to military service personnel serving overseas would be extended to any Federal government employee serving overseas. This provision would be effective January 1, 1987.

12. Oil rig, ship meals.--An employer would be entitled to a full (rather than 80-percent) deduction for the costs of (1) meals required by law to be provided to crew members on board vessels at sea, and (2) meals provided to employees on offshore drilling rigs.

Title II. Capital Cost Provisions

A. Depreciation and Investment Tax Credit Provisions

1. Depreciation of citrus trees.--Citrus trees would be assigned a recovery period of 7 years. Normal rules permitting the Treasury Department to alter this recovery period by assigning a new ADR life to this property at future times would apply. This provision would apply to trees placed in service after October 15, 1987.

2. Single-purpose agricultural and horticultural structures.--Single-purpose agricultural structures that are used for raising poultry would be assigned a recovery period of 8 years and all other single-purpose agricultural or horticultural structures would be assigned a recovery period of 12 years. Normal rules permitting the Treasury Department to alter these recovery periods by assigning new ADR lives to this property at future times would apply. This provision would apply to structures placed in service after December 31, 1987, with an exception for structures (a) acquired pursuant to a written contract that was binding on October 15, 1987, or (b) under construction or reconstruction on October 15, 1987.

3. Depreciation of farm property.--In lieu of the 200 percent declining balance/straight line method generally applicable to property assigned a 10-year or shorter recovery period, the cost of property used in farming would be recovered using a 150 percent declining balance/straight line method. This provision would apply to property placed in service after December 31, 1987, with an exception for property acquired pursuant to a written contract that was binding on October 15, 1987.

4. ITC recapture for certain involuntarily converted property.--When property is damaged or destroyed as a result of a fire, storm, or other casualty, investment tax credit (ITC) recapture may occur. The bill would provide that if the replacement property is placed in service within 2 years of the casualty, the amount of the ITC recapture would be reduced by the amount of the ITC that would have been available with respect to the replacement property. The amount of the credit that is not recaptured under this rule would reduce the basis of the replacement property.

5. Treatment of certain railroad track repairs.--Effective for taxable years beginning after 1987, railroads would be permitted to deduct currently expenses properly treated as repairs under general Federal income tax principles. The current deduction of repairs would not be treated as a change of accounting method requiring the consent of the Internal Revenue Service. The committee report would provide that no inference is intended from this

provision as to the proper treatment of such expenses incurred during 1987.

B. Low-Income Credit Provisions

1. Carryovers and reduction of credit cap--States would be permitted to carry forward 1988 credit cap for projects placed in service in 1989 that otherwise qualify for the 70 percent credit; and to carry forward 1989 credit cap for such projects placed in service in 1990. Beginning in 1988, each state's credit cap would be reduced from $1.25 per resident of the state to $1.10 per resident.

2. Family size adjustment for measuring income--Changes in family in size resulting from death, divorce, separation, or abandonment would not change the measurement of income relevant to determining the maximum rent that can be charged a qualified low-income tenant.

3. Optional income limits for defining qualified low-income families--The relevant median income applicable for defining "qualified low-income family" would be changed from the area median income to the higher of the state median income or the area median income, effective on January 1, 1988.

4. Special relief for federally aided housing projects--The bill would provide a new exception to the 10-year anti-churning rule, effective for 1988 and later credits. Housing assisted under the HUD 221(d)(3) and 236 programs which would not otherwise qualify for the credit as a result of the anti-churning rule would be eligible for credits if the Secretary of the Treasury determines that a waiver is necessary to preserve the property as low-income housing.

5. Relief from deep rent skewing rules for housing receiving Section 8 subsidies--The amendment creates a special exception to the determination of the 3:1 ratio of market rents to low-income rents for housing receiving Section 8 subsidies. For housing receiving Section 8 subsidies, the subsidy would not count towards the determination of rent.

6. Preferential recapture rule for certain large partnerships--The limit on corporate ownership of a partnership qualifying for special recapture treatment would be deleted.

7. Permit low-income housing developed as part of "zoning swaps" to qualify for the low-income housing credit--Committee report language would clarify that qualified low-income housing projects which are negotiated as zero-profit projects in connection with result of developer

[illegible] provided the projects otherwise meet all requirements.

8. Exception from 10-year anti-churning rule for certain properties owned by State or local governments.--The amendment would provide a new exception from the 10-year anti-churning rule. Under the exception, housing owned continuously and operated by a State or local government could be allocated credit cap as existing housing.

Title IV. Energy and Natural Resources

Ethanol from CBI countries.--The requirement for 1987 that 30 percent of the value of ethanol imported from a Caribbean Basin Initiative country or a U.S. possession be the indigenous product of such country or possession in order to be imported duty-free (duty of 60-cent-per-gallon) would be applied to 1988 and later years.

Title V. Tax Shelters

Extension of special transition rule sunset date for passive losses.--The last date for admitting qualified investors under the transitional exception from the passive loss rule for certain low-income housing placed in service after December 30, 1985, and before August 16, 1986, which property does not change owners after being placed in service, would be extended from December 31, 1987 (as provided in the technical corrections title) to 90 days after the date of the bill's enactment.

Title VI. Corporate Taxation

1. Insurance companies and certain section 338 elections.--In Announcement 86-47 (April 7, 1986), the Internal Revenue Service announced that it was reviewing the proper recapture treatment of certain accounts in life insurance company acquisitions in which section 338 treatment is elected, but that it would not apply any new treatment retroactively prior to the announcement date. The amendment would provide that additional recapture treatment would not apply between the date of the announcement and prior to the January 1, 1987 date of repeal of the General Utilities doctrine under the 1986 Act.

2. Treatment of copyright and computer software royalties under Subchapter S.--The treatment of copyright royalties and computer software royalties for purposes of Subchapter S would be conformed to the personal holding company rules.

3. Repeal of short-short rule.--The requirement that a regulated investment company derive less than thirty percent of its gross income from the sale or disposition of stock or securities held for less than three months would be repealed.

Title VII. Minimum Tax Provisions

1. Structured settlements.--An exception would be provided for the inclusion of income on annuity contracts under the adjusted current earnings provision, in the case of an annuity contract that is a qualified funding asset under a structured settlement arrangement. The provision would be effective with the effective date of the adjusted current earnings provision.

2. Mortgage guaranty insurers.--The purchase of tax and loss bonds would be treated as the payment of tax.

3. Rural cooperatives.--Patronage dividends of rural electric and telephone coops would not be included in book income.

4. Minimum tax treatment of certain small property and casualty insurance companies.--Small mutual property and casualty companies would not be subject to the corporate alternative minimum tax for taxable years in which an election to be taxed only on investment income is in effect.

Title VIII. Accounting

1. Uniform capitalization.--The Secretary of the Treasury would be directed to issue regulations implementing the directive of the 1986 tax Reform Act to provide a simplified method for applying the uniform capitalization rules in the case of taxpayers that acquire property for resale. The allocation ratio for apportioning storage costs and related handling costs shall be determined by dividing the amount of such costs by beginning inventory balances and gross purchases during the year.

2. Uniform capitalization.--The uniform capitalization rules would be made inapplicable to costs incurred by freelance writers and photographers. In addition, section 280 of the 1954 Code would be clarified to indicate that it did not apply to such costs for all open tax years.

3. Taxable years.--The provision would provide an election for entities required to change their taxable years as a result of section 806 of the Tax Reform Act of 1986 to retain their taxable years. Partners in an electing partnership and shareholders in an electing S corporation would be required to make enhanced estimated tax payments, subject to a $200 de minimis rule. Electing personal service corporations would be limited in the amount they could deduct currently for payments to owner-employees if they did not make sufficient payments before the end of the calendar year.

4. Long-term contracts.--A de minimis rule would be provided under which certain long-term contracts would be exempt from the lookback method.

5. Installment sales.--A portion of the indebtedness of a thrift institution would not be treated as a deemed payment on outstanding installment obligations of a manufacturer that is a member of the same controlled group.

6. Installment sales.--Installment sales by nondealers generally would not be subject to the proportionate disallowance rule. However, if the amount of installment debt arising from a sale exceeds $2.8 million or the amount of installment debt arising from all sales in a taxable year exceeds $5 million, the proportionate disallowance rule would apply. Gain on installment sales by nondealers would be recognized if the obligation was pledged. A rule would be provided to prevent avoidance of the pledge rule. Nondealers would be allowed to use the installment method for the purpose of computing alternative minimum taxable income.

7. Taxable years.--Common trust funds would be required to adopt a calendar year effective for taxable years beginning after December 31, 1987.

8. Contributions in aid of construction.--Contributions in aid of construction paid or transferred to a regulated corporate public utility with average gross receipts of less than $10,000,000 that provides water services would be treated as a nontaxable contribution to the capital of the water utility, subject to the same rules and restrictions as applied to contributions in aid of construction under section 118, prior to its amendment by the Tax Reform Act of 1986.

9. Uniform capitalization.--The preproductive period of any animal that will have more than one yield begins at the time of its acquisition or birth and ends when the animal has its first yield.

10. Installment sales.--The percentage treated as payment on outstanding installment indebtedness of a dealer under the proportionate disallowance rule for a year could not be less than 60 percent of the installment obligations arising in that year. The provision is effective for installment sales made after October 15, 1987.

Title IX. Financial Institutions

1. Provide regulatory authority to deal with FSLIC organized interim institutions for purposes of the net operating loss carryover provisions of the 1986 Tax Reform Act.

2. For losses incurred in taxable years beginning after December 31, 1986 and before January 1, 1994, allow commercial banks to elect to use the carryover period available to taxpayers other than financial institutions (3 year carryback, 15 year carryforward) instead of the carryover period mandated for financial institutions (10 year carryback, 5 year carryforward).

3. The percentage of income deductible as an addition to the reserve for bad debts of a thrift institutions in 1987 would be adjusted so that all thrift institutions would have the same effective tax rate, regardless of whether they use a calendar or fiscal year.

Title X. Insurance Products and Companies

1. Tax-exempt organizations engaged in insurance activities.--Charitable gift annuities would not be treated as commercial-type insurance for purposes of section 501(m). The IRS tables used in determining the amount of the charitable contribution would be modified to reflect current mortality assumptions and a range of interest rates. The amount of the charitable contribution would be determined on the basis of an interest rate applicable at the time the contract is issued. Until updated IRS tables are published, the most current tables (with ranges of interest rates where available) for the applicable number of lives would be used.

2. Treatment of unearned premium reserves.--Property and casualty insurance companies that are accounting for agents' commissions and other premium acquisition expenses under the holding of the Western Casualty case would be allowed to reduce the 20 percent adjustment to unearned premiums by the amount of premium acquisition expenses that are not currently deductible under Western Casualty.

Title XI. Pensions; Employee Benefits; ESOPs

1. Age 70-1/2 required distribution rule.--Qualified plans maintained by public employers would be exempt from the 1986 Act change requiring that distributions commence by April 1 of the calendar year following the calendar year in which the employee attained age 70-1/2. Thus, with respect to any employee, distribution from such plans could be deferred until the employee retires.

2. 401(k) plans for tax-exempt employers.--Tax-exempt employers that are not eligible to maintain a tax-sheltered annuity contract under section 403(b) would be eligible to maintain a section 401(k) plan.

3. Application of section 457 to nonelective deferred compensation.--The amendment would clarify that section 457 does not apply to nonelective deferred compensation.

4. Continuation health coverage sanctions.--Under the amendment, the sanction for violation of the health care continuation rules would be modified. A violation would not cause an employer to lose its deduction for its group health plans and would not cause an employer's highly compensated employees to lose their exclusion for employer-provided health coverage. Instead, the sanction would be an excise tax, generally based on the number of qualified beneficiaries affected and the period of violation. Correction of the violation would also be required.

5. Section 415 limits for public employers.--The amendment would provide that with respect to any employee first hired by a State or local government before January 1, 1989, the limit on benefits under section 415 is to equal the benefit such employee accrues under the terms of any defined benefit plan maintained by such State or local government, without regard to any amendment made after October 14, 1987. This rule would only apply to employers that elect to apply, for years beginning after December 31, 1988, the section 415 limits applicable to private, taxable employers, except that the special police and firefighters rule would still apply.

6. 401(k) plans for rural telephone cooperatives.--Rural telephone cooperatives would be permitted to maintain a section 401(k) plan.

7. TEFRA compliance date.--The amendment would conform the deadline for making plan amendments required by TEFRA for master and prototype plans to the deadline for plans other than master and prototype plans.

8. ESOP exception to reversion excise tax.--The Act provides that, in order for the exception to the reversion tax to apply, the shares acquired by an ESOP with the transferred assets must stay in the plan until distribution to plan participants. The amendment would clarify that the Secretary has the authority to provide exceptions to this requirement.

9. Distributions from ESOPs.--The amendment replaces the word "may" with the word "must" in the second sentence of section 409(n)(2) relating to distributions from ESOPs maintained by employers the charter or bylaws of which restrict stock ownership to employees or a trust described in section 401(a).

10. ESOP voting requirements.--The amendment clarifies that the one-participant-one-vote rule in section 409(e)(5) is permissive.

11. ESOP exception to early withdrawal tax.--Clarify that the Secretary has the authority to provide exceptions to the requirement in the introduced bill that the employer securities must meet the requirements of section 72(t)(C)(i) and (ii) "at all times" during the applicable period. (For example, the Secretary could provide that de minimis amounts may be held in cash, and amounts may be held in cash temporarily pending reinvestment in new employer securities following a merger or acquisition.)

12. Refinancing of ESOP loans.--The amendment would allow a lender to use the 50-percent interest exclusion applicable to certain ESOP loans with respect to a refinanced loan that would qualify for such exclusion but for the fact that the loan it is refinancing is a loan between related parties.

13. Self-insured church death benefits.--The amendment would clarify that church death benefits continue to be entitled to the exclusion from tax provided under section 101(a

Title XII. Foreign Tax Provisions

1. Interest expenses of financial services companies.--The amendment generally extends to financial institutions that deal neither with related parties nor customers of related parties treatment that the Act generally applied to banks: treatment as separate taxpayers for purposes of the interest expense allocation rules.

2. Banks organized in Puerto Rico.--The amendment excludes from the branch level taxes earnings and profits (and interest deducted that is allocable to those earnings) arising from interest on obligations of the United States derived by a possessions corporation which is engaged in the banking business in Puerto Rico. The amendment also excludes from U.S. net basis taxation portfolio interest received by these banks.

3. Earnings and profits of foreign corporations.--The Tax Reform Act of 1984 provided that, in computing a corporation's earnings and profits, the computation is made by disregarding the installment method of accounting. The 1984 Act's provision was effective, in the case of foreign corporations, for taxable years after December 31, 1985. The Tax Reform Act of 1986 delayed that effective date to taxable years after December 31, 1987. The amendment further delays that effective date one more year, to taxable years after December 31, 1988.

4. Withholding on dividends paid by regulated investment companies.--The amendment treats foreign source income derived by a regulated investment company as active foreign business income for purposes of determining the portions of dividends paid by the company that are subject to U.S. withholding tax. This rule applies only if certain anti-treaty shopping requirements are met.

5. Allocation of research and experimental expenses.--The amendment allocates and apportions expenses of U.S. R&D activities between U.S. and foreign source income by allocating to U.S. source income 67 percent of expenses (after specific allocations based on legal requirements and adjustments based on amounts treated as cost-sharing amounts with respect to possessions corporations) and allocating the remainder based on gross sales or gross income, at the taxpayer's annual election. The apportionment computation treats the affiliated group as a single taxpayer but does not take into account sales of or gross income from products produced in a possession by a possession corporation that elects (under Code section 936(h)(5)) to include in its gross income intangible property income.

5. Carryforwards of high withholding tax credits to reduce tax on financial services income.--The separate foreign tax credit limitation for financial services income would apply to post-1986 carryforwards of foreign taxes paid or accrued during tax years beginning before 1987 on income arising from certain cross-border loans which was overall limitation income under the pre-1986 Act Code, but that the taxpayer establishes would have met the definition of high withholding tax interest.

Title XIII. Tax-Exempt Bonds

1. Clarification of definition of manufacturing for qualified small-issue bonds.--Committee report language would be included clarifying that qualified small-issue bonds issued to finance a manufacturing facility may be used to finance warehouse space located on-site at the manufacturing plant being financed if the warehouse facility is integrally used in connection with the manufacturing process conducted at the plant.

2. Increase in bond volume limit for small-issuer arbitrage rebate exception.--The exemption from rebate for governmental bonds of governmental units with general taxing powers when the units issue no more than $5 million in a calendar year would be expanded to cover such governmental units issuing no more than $10 million in a calendar year.

Title XIV. Trusts and Estates; Minor Children; Gift and Estate Taxes; Generation-Skipping Transfer Tax

1. Valuation of certain farm, etc., real property.--A surviving spouse's cash rental of specially valued real property to qualified heirs would not result in the property failing to be treated as used in a qualified use for purposes of the current use valuation recapture tax.

Title XV. Compliance and Tax Administration

IRS exchange of tax information with cities.--The IRS would be authorized to enter into exchange of tax information agreements with cities having 1.5 million inhabitants or more.

Title XVI. Exempt and Nonprofit Organizations

1. College stadium seating.--If, in return for a contribution to a college or university, a taxpayer receives the right to purchase seating in its athletic stadium, the taxpayer would be entitled to a charitable contribution deduction equal to 80 percent of the contribution in excess of the ticket purchase costs. This provision would apply to amounts paid in taxable years beginning after January 1, 1984.

2. Mailing lists.--The Tax Reform Act of 1986 provided that section 501(c)(3) organizations are not subject to unrelated business income tax (UBIT) when they exchange or rent to other 501(c)(3) organizations mailing lists consisting of the names and addresses of donors or members. This rule would be extended to apply similarly to social welfare organizations described in section 501(c)(4), effective as of the date of enactment.

Title XVII. Miscellaneous Provisions

1. Certain tolerances permitted in determination of wine excise tax.--Regulatory authority would be granted to the Treasury Department to permit tolerance levels in the amount of taxable wine contained in a bottle, provided that the tolerances prescribed may not affect revenue.

2. Collection of gasoline excise tax.--Gasoline wholesalers satisfying financial responsibility requirements to be prescribed by the Treasury Department would be permitted to remit the gasoline excise tax, effective after December 31, 1987. The taxable event would not change as a result of this amendment.

3. Clarifying the certification requirements for WIN credits.--The provision would clarify that certifications for the work incentive jobs credit (sec. 50B(h)(1) of the IRC as in effect for taxable years beginning before January 1, 1982) must be made on or before the day the individual begins work. This provision would be effective for purpose of credits first claimed after March 11, 1987.

Title XVIII. Other Provisions

1. Workers' compensation funds.--In the case of workers' compensation funds, (1) the funds would be granted relief from deficiency assessments relating to the timing of policyholder dividend deductions for taxable years beginning before January 1, 1987; and (2) the changes to the taxation of property and casualty insurance companies (discounting, treatment of unearned premiums, and proration) enacted by the 1986 Act would be effective for taxable years beginning on or after January 1, 1989.

2. For purposes of outlay provisions agreed to prior to the August recess, the effective date will be November 20, except for expiring provisions and demonstration projects.

3. Clarifying language will be added to insure that section 202 of Gramm-Rudman-Hollings does not apply to any provision.

Amendments to Other Tax Legislation

1. Exemption from harbor maintenance tax for donated cargo.--The provision would exempt donated cargo from the harbor maintenance excise tax. The tax is 0.04 percent of the value of commercial cargo, and is imposed on any cargo loaded or unloaded at a U.S. port.

2. Application of harbor maintenance tax to imported and exported cargo loaded or unloaded on another vessel.--The provision would provide that the harbor maintenance tax is to apply only once with respect to particular imported or exported cargo that is transferred from one vessel to another for shipment to a different U.S. port.

3. Collection of alcoholic beverage excise taxes.--A transitional exception would be provided permitting transfers of imported bottled alcoholic beverages from certain foreign trade zones without payment of tax. The exception would apply to certain foreign trade zones that processed these alcoholic beverages before enactment of the Omnibus Budget Reconciliation Act and would be limited to annual quantities specified in the bill.

4. One-year Extention of Commencement Date of Oil Spill Liability Trust Fund and Tax on Petroleum.--The commencement date of the Oil Spill Liability Trust Fund and 1.3 cent per barrel petroleum tax would be extended so that the trust fund and tax would take effect if qualified legislation authorizing an oil spill liability program were enacted by September 1, 1988. The provision would be effective upon date of enactment.

5. Crude Oil Windfall Profit Tax Act of 1980.--Crude oil attributable to interests in the San Juan Basin Trust or the Permian Basin Trust with respect to which the Ella C. McFadden Charitable Trust was treated as the producer for purposes of the windfall profit tax (1) shall be allocated among trust beneficiaries on the basis of their respective shares, and (2) any such oil allocated to Texas Wesleyan College shall be treated as oil from a qualified charitable interest. The provision would be effective after February 29, 1980.

PART FOUR: FAMILY WELFARE REFORM ACT

The Budget Reconciliation provisions include H.R. 1720 (the Family Welfare Reform Act of 1987), as reported by the Committee on Ways and Means.

H.R. 1720 makes improvements in the basic Federal welfare program, Aid to Families with Dependent Children (AFDC). Included in the Act is a mandatory work, education and training program for AFDC recipients that is targeted to those who may be long-term dependent, coupled with support services (principally day care and health benefits) for working single parents.